

# UNIVERSITY OF COLOMBO, SRI LANKA

## FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration Honours in Accounting (Semester V) Examination –  
August, 2021

### ACT 3210 – Working Capital Management

Two (02) Hours

This is an Open Book Examination

This Paper Consists of Four (04) Questions Printed on Six (06) Pages

Answer All Questions

Use of Calculators is Permitted

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1. i. “Management of working capital ensures the efficient allocation of resources of a firm”.  
Elaborate on this statement.

(04 Marks)

- ii. The following details are extracted from the Statement of Financial Position of Vision Good Company.

Rs. ‘000

<b>Assets</b>	
Non-current assets	40,600
Current assets	<u>9,400</u>
Total Assets	<b><u>50,000</u></b>
<b>Liabilities</b>	
Long-term funds	46,800
Current liabilities	<u>3,200</u>
Total Liabilities	<b><u>50,000</u></b>

The company has found that its current assets earn 4%, non-current assets earn 9%, current liabilities cost 3%, and long-term funds cost 7%.

- a. Based on the above information, calculate the net profitability of the company.

(04 Marks)

- b. The company is considering to reduce its net working capital by Rs. 2,200,000 by shifting current assets into non-current assets **or** shifting long-term funds into current liabilities. Select the most appropriate alternative by analyzing the above information.

(04 Marks)

- iii. Luck Super Traders is contemplating its working capital investment and financial policies for the next year. Estimated non-current assets and current liabilities for the next year are Rs. 3.60 million and Rs. 2.52 million, respectively. Finance Manager of the company is examining the following alternative working capital policies.

<b>Working capital policy</b>	<b>Investment in current assets</b> <b>(Rs. in million)</b>
Conservative	3.90
Moderate	3.40
Aggressive	2.80

After evaluating the working capital policy, Finance Manager has decided to adopt the 'moderate working capital policy.' The company expects to use Rs. 3.08 million of equity funds. To finance the balance amount, the company is considering the following debt options under alternative financing policies.

<b>Financing Policy</b>	<b>Short-term debt</b>	<b>Long-term debt</b>
Conservative	30%	70%
Moderate	60%	40%
Aggressive	80%	20%
Interest rate	5%	9%

Using the above information;

- a. Find the net working capital position under each working capital investment policy before adopting the moderate working capital policy.

(03 Marks)

- b. Calculate the debt requirement and interest cost under each working capital financing policy after adopting the moderate working capital policy.

(07 Marks)

- c. Find the net working capital position under each working capital financing policy after adopting the moderate working capital policy

(03 Marks)

**(Total 25 marks)**

2. i. Briefly explain the impact of the following scenarios on working capital needs of a firm.

- a. Availability of liberal credit terms from suppliers of the firm
- b. Issuance of bonus shares instead of cash dividends
- c. Identification of a higher amount of depreciation

(06 Marks)

- ii. The following particulars are abstracted from the recent financial statements of Products Win company.

<b>Particular</b>	<b>Rs. 000'</b>
Stock	
Raw materials	320
Work-in-process	190
Finished goods	270
Purchase of raw materials	2,560
Cost of goods sold	3,600
Sales revenue	4,800
Trade debtors	460
Trade creditors	240

The company assumes 360 days in a year for their calculation purpose.

Based on the above information;

- a. Calculate net operating cycle (clearly state your assumptions, if any).

(10 Marks)

- b. If the company maintains its raw material stock as Rs. 256,000 while trade debtors as Rs. 580,000, what is the impact on net operating cycle which you calculated in (a) above? (Assume all other figures remain the same).

(04 Marks)

iii. Summary details of the cash budget from July 2021 to December 2021 are extracted from Avendra PLC.

Month	Jul'	Aug'	Sep'	Oct'	Nov'	Dec'
Cash inflows (Rs. 000')	2,100	1,700	900	1,100	1,600	1,700
Cash outflows (Rs. 000')	700	1,300	1,800	1,300	1,500	2,000

At the beginning of July, the company had Rs. 1,000,000. However, the Finance Manager has decided to maintain a minimum cash balance of Rs. 1,800,000 at the end of each month from July onwards. If the firm meets any cash deficiency, bank borrowings are obtained under 12% annual interest. Interest cost will be paid at the end of each month.

a. Find the cash balance of the company at the end of September.

(01 Mark)

b. In which month(s) the company needs to raise borrowings? And how much it needs to borrow in each month?

(02 Marks)

c. Calculate the interest cost of December.

(02 Marks)

**(Total 25 marks)**

3. i. A firm is offered with the credit term of '2/10 net 30'. If the short-term borrowing rate is 9%, should the firm pay within the discount period? Advise.

(03 Marks)

ii. List any three (03) functions of a factor other than providing financing facilities.

(03 Marks)

iii. Star Granite Ltd sells standard type granites (per square feet). At present, the company is considering to relax existing credit terms to three of its large customers, namely, A, B, and C. The credit period and expected units of granites that the customers will buy are as follows.

Credit Period	Expected units bought by the customer		
	A	B	C
0 days	500	500	-
30 days	500	750	-
60 days	500	1,000	500
90 days	500	1,250	750

The selling price per unit is Rs. 6,000. The expected contribution is 20% of the selling price. The average cost of carrying debtors is 20% per annum.

Using the above information;

a. Determine the appropriate credit period for each customer (assume 360 days in a year for calculation purposes).  
(13 Marks)

b. What are the possible problems the company might face in allowing the credit period as determined in (a) above? (Hint: All customers know information of each other).  
(02 Marks)

iv. ABC inventory classification system has merits and demerits. Do you agree with this statement? Explain.

(04 Marks)

**(Total 25 marks)**

4. State whether you agree or disagree with the following statements. Justify your answer with sufficient explanations.

i. If a discount date is missed for some reason, a rational firm should pay the bill on the final due date.

(05 Marks)

ii. It is always better to engage in a factoring agreement if the cost of factoring is lower than the cost of in-house management of trade receivables of a firm.

(05 Marks)

iii. Cheque encashment analysis can be used as a technique to delay payments of account.

(05 Marks)

iv. An increased credit period to customers may have a positive and a negative impact on the profitability of a firm.

(05 Marks)

v. The Miller-orr Model is more appropriate than the Baumol Model as an approach to determine the cash needs of a firm.

(05 Marks)

**(Total 25 marks)**